No. 15,046

IN THE

United States Court of Appeals

For the Ninth Circuit

WELLS FARGO BANK & UNION TRUST CO., Executor of the Will of Walter D. K. Gibson, Deceased,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

On Appeal from the Judgment of the United States District Court for the Northern District of California.

BRIEF FOR THE APPELLEE.

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BRIEF FOR THE APPELLEE.

OPINION BELOW.

The District Court's findings of fact (R. 44-46) and conclusions of law (R. 46-47) are not officially reported. The District Court's memorandum opinion (R. 37-43) is reported in 134 F. Supp. 340.

JURISDICTION.

This appeal involves federal income tax in the amount of $7,100.35 (R. 39, 44), assessed against the executor of Walter D. K. Gibson's estate as part

of a deficiency based on such executor's failure to report one-half the income attributable to property subject to administration during the period January 1, 1941, through August 26, 1941. (R. 38.) The assessed deficiency, which amounted to $9,161.19, plus interest, was paid on July 11, 1945, and January 17, 1947. (R. 9.) Taxpayer executor for the estate of Walter D. K. Gibson, deceased, filed claim for refund in that amount on June 30, 1947. (R. 9, 46.) On April 12, 1950, the claim was allowed by the Commissioner of Internal Revenue, who reduced the amount payable by $7,100.35, the sum of a proposed deficiency in the tax due from Emily A. Gibson, deceased. (R. 10-11, 46.) The balance of $2,060.84, plus interest, was paid to taxpayer-executor on April 12, 1950. (R. 46.) On April 13, 1950, the Commissioner notified taxpayer that its claim for refund was disallowed to the extent not previously allowed by the certificate of overassessment of April 12, 1950. (R. 46.) Thereafter, more than six months having elapsed, taxpayer-executor, within the time provided by Section 3772 of the Internal Revenue Code of 1939, instituted this suit for refund (R. 5-13) on April 11, 1952 (R. 13). Jurisdiction was conferred on the District Court by 28 U.S.C., Section 1346. On November 23, 1955, judgment was filed for the United States, dismissing taxpayer-executor's suit for refund. (R. 49.) Within sixty-one days, the sixtieth day having fallen on Sunday, January 22, 1956, taxpayer-executor filed its notice of appeal on January 23, 1956. (R. 49-50.) Accordingly, the amount of federal income taxes here involved is $7,100.35. (R. 44.) This

Court has jurisdiction conferred by 28 U.S.C., Section 1291.

QUESTIONS PRESENTED.

1. Whether, as held by the District Court, the income for the period of administration prior to distribution between January 1, 1941, and August 26, 1941, attributable to the property subject to administration in the estate of the husband, Walter D. K. Gibson, was taxable to his estate or, whether, on the other hand, as taxpayer claims, one-half of this income was taxable to the estate of his wife Emily.

2. In the alternative, whether equity requires that any judgment in favor of taxpayer be reduced by the amount that will go to the heirs of Emily Gibson.

STATUTE INVOLVED.

Internal Revenue Code of 1939:

> Sec. 162. Net Income.
>
> The net income of the estate or trust shall be computed in the same manner and on the same basis as in the case of an individual, * * *
>
> * * * * * * *
>
> (26 U.S.C. 1952 ed., Sec. 162.)

STATEMENT.

The pertinent facts, as stipulated (R. 17-28, 33-36) and as found by the District Court (R. 37-39, 44-46), can be summarized as follows:

Wells Fargo Bank & Union Trust Company (hereinafter called taxpayer) is the executor of the will (Ex. 1, Appendix, *infra*) of Walter D. K. Gibson (hereinafter called Walter), who died on December 21, 1938. Walter's estate was in the course of administration until August 26, 1941. Under the terms of his will, his property was placed in trust, with his wife Emily being named as the income beneficiary. (R. 37.)

Walter's will was executed on August 31, 1937. (R. 18.) Among other things, it stated that its provisions were conditioned on his wife's waiving her right to take one-half of their California community property. Such a waiver (Ex. 2, Appendix, *infra*) was executed by Walter's wife, Emily, contemporaneously with the execution of the will. The will also gave Emily the power to withdraw one-half of the amount of the corpus of the trust for any purpose she might desire. (R. 37-38.)

As executor, taxpayer administered Walter's estate from January 11, 1939, until August 26, 1941, on which latter date the assets were distributed in accordance with a decree of final distribution, without the taxpayer, however, being discharged as executor.

On May 8, 1941, under the power given her in Walter's will, Emily assigned fifty per cent of the trust property to Crocker First National Bank of San Francisco to hold, as trustee, under a trust created by herself. Under the August 26, 1941, decree of final distribution, this assigned property was distributed by taxpayer to Crocker First National Bank.

Then, on November 24, 1941, Emily Gibson, the surviving spouse, died. (R. 18-19.)

On the 1941 fiduciary income tax return filed on behalf of Walter's estate, taxpayer reported only $19,690.65, representing one-half of the income attributable to the property subject to its administration, as executor, during the period January 1, 1941, to August 26, 1941, the final distribution date. Meanwhile, the other half of such income received during the taxable period—*viz.*, $19,690.65—was reported on the last income tax return filed for the decedent's wife for the period from January 1, 1941, to November 24, 1941, the date of Emily's death. During the taxable period January 1, 1941, to August 26, 1941 (the final distribution date), the gross income attributable to the property subject to administration amounted in total to $39,381.30. (R.19.)

The Commissioner proposed a deficiency assessment of $9,161.19 against Walter's estate (R. 19-20) on the ground that the entire $39,381.30 received as income during the period from January 1, 1941, to August 26, 1941, was taxable to the deceased husband. Concurrently, an overassessment was proposed with respect to the tax paid by the estate of the wife. By agreement between the parties the deficiency assessed against the husband's estate was satisfied by setting off against it the overassessment in favor of the estate of the wife and the balance was paid in cash. The wife's estate was reimbursed for the use of this certificate of overassessment. That amount was charged by the husband's estate to his heirs. (R. 38.)

Thereafter, on June 30, 1947, tax payer, as executor for Walter's estate, filed a claim for refund of income taxes in the sum of $9,161.19 for 1941 on the ground that for the period in question only one-half of the income was chargeable to his estate, the other half being chargeable to the estate of Emily Gibson. On April 12, 1950, the Commissioner allowed this claim but reduced the amount payable by $7,100.35, the sum of a proposed deficiency in the tax due from the estate of the wife, Emily Gibson. The balance of $2,060.84, plus interest of $347.83, was paid to taxpayer on April 12, 1950. On April 13, 1950, the Commissioner notified taxpayer that the claim for refund was disallowed to the extent not previously allowed. The Commissioner thereby disallowed the claim for refund to the extent of $7,100.35. (R. 23-25, 39-46.)[1]

The District Court concluded that the election by the wife, Emily A. Gibson, to waive her community property rights and take according to the will changed the character of the community interest on the death of her husband and the entire community property became the estate of the husband, and accordingly, that the Commissioner properly determined in accordance with law that taxpayer was liable for income

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[1]The net overassessment allowed Walter's estate was $2,060.84, together with interest thereon of $347.83, or a total sum of $2,407.67. The claim for refund filed by Walter's estate was based on an alleged overassessment of 1941 income tax in the amount of $9,362.58. The difference between the $9,362.58 claimed and the $2,060.84 allowed would thus appear to be $7,301.74. However, because of minor adjustments correcting an understatement of capital loss and an overstatement of trust income, the agreed amount of the difference was $7,100.35. (R. 24-25.)

taxes upon the entire income of the estate of Walter D. K. Gibson. (R. 46-47.)[2] The District Court entered judgment dismissing the complaint. (R. 48-49.)

SUMMARY OF ARGUMENT.

I.

We submit that, under the facts here obtaining, the District Court correctly held that upon Walter's death, Emily's waiver and election agreement, upon which Walter's will was conditioned, operated to change the character of her previously existing community ownership and convert what had been her one-half share into separate estate property, with her interest therein being that of a beneficiary. Moreover, we submit that the District Court was correct in holding that the existence of this waiver and election agreement patently serves to distinguish this case from the situation which was before this Court in *Bishop v. Commissioner,* 152 F.2d 389, and in *United States v. Merrill,* 211 F.2d 297. Taxpayer's attempt to rely on the *Bishop* principle in this case is entirely unwarranted since neither *Bishop* nor *Merrill* presented factual circumstances wherein the spouses had

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[2]During the course of the trial, the Government sought to interpose a counterclaim for recovery of $2,408.67, the amount of principal and interest paid to taxpayer on April 12, 1950, and which it alleged had erroneously been refunded. (R. 24, 42-43, 46.) The District Court, however, denied the Government's motion for leave to file such a counterclaim (R. 43, 47) and the Government has not appealed.

entered into an agreement to change the character of the surviving wife's previously existing community ownership interest to separate property of the deceased husband's estate, with the wife sharing therein only as a beneficiary under the will.

Ample authority exists in the established decisions of this Court and the California courts, as well as in the pertinent California statutes, to support the correctness of the District Court's decision in this case. Under these decisions, it has long been settled that spouses may agree to transmute their community property to the separate estate of both or either by an agreement which ordinarily need not be executed with any particular formality. Settled also is the proposition that a single written instrument agreed to by both spouses may constitute both a will and a contract. Equally established is the corollary principle that an election by the surviving spouse to take under the will is binding and enforceable as a contract under California law. All of these principles have been accorded recognition by this Court in permitting spouses, under appropriate circumstances, to change the character of property from community to separate and thus alter the nature of the property for federal income tax purposes.

For the reasons stated above, we submit that the District Court was correct in holding that the entire income received during the taxable period of administration prior to final distribution should be taxed to Walter's estate. Neither is there any merit in taxpayer's attempt to argue that one-half of the in-

come of Walter's estate should be taxed to Emily A. Gibson, deceased.

II.

As an alternative argument, we submit that should this Court not agree with the Government's contention in Point I, *supra,* seven-eighths of the judgment will inure to the benefit of Grace Collins and Walter Gibson, Jr., the heirs of Emily Gibson. The rendering of such a judgment will mean that one-half of the income received between January 1, 1941, and August 26, 1941, should have been taxed to the estate of Emily Gibson. Accordingly, equity requires that any judgment in favor of the taxpayer should be reduced by the amount that will go to Emily Gibson's heirs.

The result indicated above follows from the fact that Grace Collins and Walter Gibson, Jr., upon recovery of the tax here in issue, will receive seven-eighths of the refund under the terms of the decree of final distribution, as agreed to by the parties. At the same time, as residuary legatees of the estate of Emily, Grace Collins and Walter Gibson, Jr., as transferees, would owe the tax which would otherwise be assessable as a deficiency against the estate of Emily Gibson, were it not for the bar of the statute of limitations. In such circumstance, we submit that, upon equitable principles, the Government has the right to recoup the amount that will go to the same persons who should bear the burden of the tax on the same income. *Stone v. White,* 301 U.S. 532, rehearing denied, 302 U.S. 639. Therefore, if the

Government retains seven-eighths of the amount of any judgment inuring to the benefit of Grace Collins and Walter Gibson, Jr., the taxpayer-executor will have suffered no burden and the Government will not be unjustly enriched. Neither does the fact that a judgment in favor of the taxpayer might operate to lift the bar against assessment of the tax against the estate of Emily Gibson or its transferees weaken the Government's argument for application of the doctrine of equitable recoupment. The mere fact that another remedy exists is no bar to asserting an equitable remedy which will here, to the extent that recoupment is allowed, avoid circuity of action. Neither is there any merit in taxpayer's attempt, under these circumstances, to limit the clearly applicable rule of *Stone v. White, supra,* as laid down by the Supreme Court.

ARGUMENT.

I.

THE DISTRICT COURT CORRECTLY HELD THAT ALL THE INCOME FOR THE PERIOD OF ADMINISTRATION PRIOR TO DISTRIBUTION BETWEEN JANUARY 1, 1941, AND AUGUST 26, 1941, ATTRIBUTABLE TO THE PROPERTY SUBJECT TO ADMINISTRATION IN THE ESTATE OF THE HUSBAND, WALTER D. K. GIBSON, WAS TAXABLE TO HIS ESTATE.

We submit that, with respect to the sole issue here on appeal, the District Court correctly concluded (R. 42):

> * * * in the case at bar, the Court finds that Emily Gibson's waiver changed the character

> of the community interest upon the death of her husband and that the executor of the Last Will of Walter Gibson was liable for the full amount of taxes assessed against it. * * *

Under the facts here obtaining, the spouses, Walter and Emily Gibson, who were residents of California owning community property, entered into an agreement on August 31, 1937, expressly designed to change the character of the community ownership to separate property of Walter's estate, which could be distributed under his will at his death. This agreement was effected by Walter's expressly conditioning his will upon Emily's contemporaneous execution of a waiver agreement, pursuant to which, in consideration of the provisions made for herself and the children in the husband's will, she waived all right to her one-half community ownership and elected to take under the will. This agreement became operative on December 21, 1938, when Walter died, with his estate being administered by taxpayer-executor until August 26, 1941, the date of final distribution. In addition to its being conditioned on Emily's waiver of her community ownership rights, the will created a testamentary trust composed of all the property, with Emily as income beneficiary for life, and also granted Emily a power to withdraw up to one-half of the trust property for any reason she might wish. In point of fact, Emily, on May 8, 1941, exercised this power by assigning half of the trust corpus to a trust of which she was the settlor. On August 26, 1941, the final distribution date, this property

was distributed by Walter's executor to Emily's trustee. Thereafter, on November 24, 1941, Emily died.

During the final period of administration of Walter's estate prior to distribution—*viz.,* January 1, 1941, to August 26, 1941—income attributable to the estate property was received in the amount of $39,381.30. In its federal income tax return for the period, Walter's executor returned only $19,690.65, or one-half of this amount. The remaining $19,690.65 was reported in Emily's final income tax return for the period January 1, 1941, to November 24, 1941, the date of her death. A deficiency was assessed against taxpayer-executor for failure to include all of the income—*viz.,* $39,381.30. The deficiency was paid by offsetting, in part, an overassessment credit of $7,100.35 due Emily A. Gibson, deceased, on the $19,690.65 which had been reported on her final return. The instant suit for refund was commenced to recover this $7,100.35, which was not refunded to Walter's executor in cash.

The correctness of the trial judge's decision is clearly supported by the facts and by the pertinent federal and California court decisions. Neither should any significance be attached to taxpayer's attempt (Br. 10-21) to apply the now settled rule of *Bishop v. Commissioner,* 152 F.2d 389 (C.A. 9th), to this clearly distinguishable set of facts. As the District Judge pointed out (R. 39-42) below, this is clearly *not* a case to which the holding in the *Bishop* case applies.

Here, the deceased husband's will (R. 18; Ex. 1, Appendix, *infra*) was expressly conditioned on Emily Gibson's contemporaneously executed waiver (R. 18; Ex. 2, Appendix, *infra*) of all "right to claim one-half (½) or any part of the community property" upon her husband's death. Under the waiver, "in consideration of its [viz., the will's] provisions therein contained for my benefit and for the benefit of others therein mentioned," Emily agreed to the terms of the will, which, in turn, expressly obligated her to "elect to accept the provisions of this my Last Will and Testament made herein for her benefit." Accordingly, since Walter D. K. Gibson predeceased Emily, dying on December 21, 1938 (R. 17), the *entire* amount of the community property (which was the subject of the spouses' express agreement incorporated in Walter's will and Emily's waiver and election) became subject to administration in taxpayer-executor's hands under the terms of Walter's will. In other words, as the District Court correctly pointed out (R. 42), the result achieved by the agreement of August 31, 1937—*vis.*, the execution by the spouses of the will and the waiver (R. 45)—was the conversion of the community property, at Walter's death, into separate property subject to administration in Walter's estate. Under the express terms of the waiver, moreover, as the District Court observed (R. 40), Emily elected to share in Walter's estate *as a beneficiary,* deriving all subsequent interest in the property through such relationship. Accordingly, as between Emily and taxpayer-executor, consistent with her express agreement to assume contractually

the role of beneficiary, no *ownership*[3] obligation fell upon the surviving spouse to pay any federal tax on the estate's *income*[4] during the period of administration until a *distribution* was made, which here took place on August 26, 1941. (R. 17-18.)

Ample support for the proposition developed above can be found in the decisions of the California courts and the pertinent state statutes dealing with community property. It has long been settled, since the

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[3]See *Bishop v. Commissioner, supra*, where this Court laid down the "ownership" test, as follows (p. 390):

> Being the owner of a one-half interest in the community property, petitioner owned one-half of the income therefrom. Since ownership is the test of taxability, petitioner's half of the $4,563.40 was taxable to her, not to the estate.

[4]Emphasis is here warranted on the fact that the tax involved is federal tax on income attributable to property administered by the taxpayer (as executor of Walter's estate) during the predistribution period from January 1, 1941, to August 26, 1941, in contrast to a federal *estate* tax arising on the *transfer* of property at Walter's death—*viz.*, December 21, 1938. (R. 17.) In this connection, Walter and Emily's agreement, incorporated in the will and the waiver executed on August 31, 1937 (R. 18), provided for the actual *transfer* of the property to taxpayer-executor which here took place upon Walter's death, with federal *estate* tax consequences which are not here in issue. Accordingly, as the District Court pointed out (R. 40-41), *Pacific National Bank of Seattle v. Commissioner*, 40 B.T.A. 128 (Acquiescence, 1939-2 Cum. Bull. 28), and *Coffman-Dobson Bank & Trust Co. v. Commissioner*, 20 B.T.A. 890 (Acquiescence, X-1 Cum. Bull. 13 (1931), both of which are mistakenly relied on by the taxpayer, are not in point since both of these decisions involve principles of estate tax rather than income tax and hold that community property, though administered by the estate of the first spouse to die, is subject to an estate tax only on the one-half properly attributable to the decedent. In contrast to the issue here presented, they do not rule that unit created by the will of the decedent under a valid election of one of the spouses, may be considered thereafter as a community interest divisible for income tax purposes during the period of probate administration.

decision in *Marlow v. Barlew,* 53 Cal. 456, 459, that the spouses may agree with respect to the character of the property which they hold to transmute such property from community to the separate estate of both or either by an agreement which ordinarily need not be executed with any particular formality. *Kenney v. Kenney,* 220 Cal. 134, 30 P.2d 398; *Rothschild v. Davis,* 217 Cal. 660, 20 P.2d 329; *Siberell v. Siberell,* 214 Cal. 767, 7 P.2d 1003; *Estate of Kelpsch,* 203 Cal. 613, 265 Pac. 214; *Title Insurance Etc. Co. v. Ingersoll,* 153 Cal. 1, 94 Pac. 94; *Collins v. Sword,* 4 Cal. App.2d 437, 41 P.2d 170; *McCall v. McCall,* 2 Cal. App.2d 92, 37 P.2d 496; *Young v. Young,* 126 Cal. App. 306, 14 P.2d 580; *Estate of Sill,* 121 Cal. App. 202, 9 P.2d 243; *Estate of Wyss,* 112 Cal. App. 487, 297 Pac. 100; *Estate of Wahlefeld,* 105 Cal. App. 770, 288 Pac. 870; *Vieux v. Vieux,* 80 Cal. App. 222, 251 Pac. 640; *Martin v. Pritchard,* 52 Cal. App. 720, 199 Pac. 846, and Deering's Civil Code of California (1931), Sec. 158. Equally well established is the proposition that a single written instrument agreed to by both spouses may constitute both a will and a contract. *Estate of Watkins,* 16 Cal.2d 793, 108 P.2d 417; *Security-First Nat. Bank v. Stack,* 32 Cal. App.2d 586, 90 P.2d 337; and *Norton v. Estate of Norton,* 41 Cal. App. 614, 183 Pac. 214. As the trial court pointed out (R. 40), the corollary proposition is equally well settled that an election by the surviving spouse to take under the will is binding and enforceable as a contract under California law. *Estate of Watkins, supra; Flanagan v. Capital Nat. Bank,*

213 Cal. 664, 3 P.2d 307, and *Security-First Nat. Bank v. Stack, supra.*

Applying the above principles of California community property law, this Court has frequently had occasion to recognize that Sections 158 and 159 of the Civil Code of California permit the spouses, by their contract, to change the character of property from community to separate and thus alter the nature of the property for federal *income* tax purposes. *O'Bryan v. Commissioner,* 148 F.2d 456, 458; *Van Dyke v. Commissioner,* 120 F.2d 945, 947; *Boland v. Commissioner,* 118 F.2d 622, 624; *Sparkman v. Commissioner,* 112 F.2d 774, 776-777, and *Helvering v. Hickman,* 70 F.2d 985, 987-988.

At the trial below, the District Court, we submit correctly, applied the well-established principles expounded in the above-cited state and federal decisions to hold (R. 42) that, upon Walter's death, the waiver and election executed by Emily Gibson operated to change the character of her prewaiver interest in the community property, with the result that (R. 40) her previously existing community interest was converted into separate estate property, with her interest in Walter's estate being that of a beneficiary. As the trial judge pointed out (R. 39-40), such a conclusion is in no way inconsistent with the result reached in *Bishop v. Commissioner, supra,* since the *Bishop* case is clearly distinguishable on its facts in that no waiver and election agreement were there entered into between the spouses to change the character of the surviving wife's previously existing com-

munity property ownership interest.[5] Accordingly, the rationale of the *Bishop* case has no valid applicability to the facts of this case and the taxpayer's reliance thereon (Br. 10-13) is completely unwarranted. Equally ineffective is taxpayer's argument (Br. 13-15) that the waiver contract lacked mutuality of obligation because, in electing to take under the will, Emily was granted a power to withdraw one-half of the corpus of the Emily A. Gibson trust estate, created thereunder for her life benefit. Clearly, the grant of this power of invasion *under the will* in no respect vitiates the validity of the waiver contract itself, which was entered into on August 31, 1937, "in consideration of its [*viz.,* the will's] provisions therein contained for my benefit and for the benefit of others therein mentioned." The requisite mutuality of obligation was thus created on execution of the waiver contract. As of that date, Emily, for adequate consideration, agreed to the conversion of her previously existing community ownership interest to separate property of Walter's estate at the time of his death. Accordingly, the coincidence that the community ownership which would have then existed but for the waiver contract amounted to one-half, whereas the power of invasion, upon exercise by Emily as life beneficiary, could reach one-half of the testamentary Emily A. Gibson trust corpus, can not serve to indicate a lack of enforceability of the waiver contract, as taxpayer attempts (B. 14) to

[5]See also *United States v. Merrill,* 211 F. 2d 297 (C.A. 9th), which is likewise clearly distinguishable from the instant case for the same reason.

claim. On the contrary, taxpayer's reliance on the testamentary trust and the power of invasion, purportedly (Br. 14) to demonstrate Emily's ability to "withdraw her consideration," evidences, realistically, the *validity* of the *waiver contract.* This follows from the fact that both the trust and the power were created under Walter's will, which, in turn, was conditioned on the validity of the waiver contract.

Again, it is of no avail to taxpayer to attempt to argue (Br. 15-21) that the grant, under the will, of the power of invasion was, in effect, a power of revocation, within the meaning of Section 166 of the Internal Revenue Code of 1939 (26 U.S.C. 1952 ed., Sec. 166). As has been pointed out above and as the trial court held, under both the established California decisions and those of this Court, the waiver contract operated to convert Emily's previously existing community ownership to separate property of Walter's estate, subject to the provisions of his will. Under the will, Walter, and *not* Emily, was the *grantor* of the testamentary Emily A. Gibson trust. Accordingly, it becomes impossible to claim that there could be a power of revocation in Emily, since her relationship to the trust was that of a *beneficiary* and *not* that of a *grantor.* Under no circumstance could an exercise of the power of invasion operate to revest title to any part of the trust corpus in the decedent grantor. Moreover, as we pointed out above (fn. 3, *supra*), the *Pacific National Bank of Seattle* and *Coffman-Dobson Bank & Trust Co.* cases, *supra,* here relied on by taxpayer (Br. 18-19), are concerned

solely with the issue of includibility in Walter's gross estate for federal *estate* tax purposes and have no applicability to the federal *income* tax issue here before the Court.

II.

SHOULD THIS COURT GRANT JUDGMENT IN FAVOR OF THE TAXPAYER, SEVEN-EIGHTHS OF THE JUDGMENT WILL INURE TO THE BENEFIT OF THE HEIRS OF EMILY GIBSON. THE RENDERING OF JUDGMENT WILL MEAN THAT ONE-HALF OF THE INCOME SHOULD HAVE BEEN TAXED TO THE ESTATE OF EMILY GIBSON. EQUITY REQUIRES THAT ANY JUDGMENT IN FAVOR OF THE TAXPAYER BE REDUCED BY THE AMOUNT THAT WILL GO TO THE HEIRS OF EMILY GIBSON.

The Government reiterates its contention (Point I, *supra*) that the income in question is properly taxable in its entirety to the estate of Walter Gibson. However, should the Court not affirm the District Court on this ground, an alternative defense is here available. In substance, this defense is that the Government has a paramount right to the monies sought, at least to the extent that a judgment will inure to the benefit of the heirs of Emily Gibson. This defense was expressly raised in the answer (R. 16) but the District Court (R. 42) found it unnecessary to rule upon it.

An action brought to recover taxes erroneously paid is predicated on the same equitable principles that underlie an action *in assumpsit* for money had and received. *United States v. Jefferson Electric Co.*, 291 U.S. 386. Recovery can be had only by virtue

of a right measured by equitable standards. It is therefore open to the Government to show any state of facts which, according to these standards, would deny the right. *Stone v. White,* 301 U.S. 532, rehearing denied, 302 U.S. 639; *Lewis v. Reynolds,* 284 U.S. 281. It is true that the Government cannot resurrect barred deficiencies for other years and claim recoupment based on them. *McEachern v. Rose,* 302 U.S. 56. It can, however, show offsetting items for the same year which cannot at the time of suit be assessed because of the statute of limitations.

Should the Court render judgment in favor of the taxpayer, it will in effect be deciding that one-half of the income in question was taxable to the estate of Emily Gibson. Assessment of a deficiency against that estate is at this time barred. However, the tax which should have been paid, if that is the decision of the Court, was a tax on the same income with respect to which the taxpayer claims an overpayment. In *Stone v. White, supra,* the Supreme Court held that where an overpayment by a trust would, if recovered, go directly to the beneficiary who should have paid the tax, the amount of tax owed by the beneficiary could properly be asserted by way of recoupment. Our primary question here is, therefore, who were the beneficiaries of Walter Gibson's estate, and who were the beneficiaries of Emily Gibson's estate?

If recovery is had by the taxpayer, the money will be distributed one-half to the Crocker First National Bank of San Francisco under the trust created by

Emily Gibson, one-eighth outright to Walter Gibson, Jr., one-eighth in trust to Joanne Gibson and one-fourth in trust to Grace Collins. (R. 22-23.) The residuary legatees of the estate of Emily Gibson were Walter Gibson, Jr., and Grace Collins. (R. 23.) Walter Gibson, Jr., and Grace Collins are, therefore, the persons who would owe the tax as transferees of the estate of Emily Gibson. However, with the exception of the one-eighth which would go to Joanne Gibson, they are the very persons who would benefit under any judgment in this case. The one-half of the judgment which would go to the Crocker First National Bank would be for the beneficiaries of two trusts, the beneficiary of one being Grace Collins (R. 34, 36) and the beneficiary of the other being Walter Gibson, Jr. (R. 34-35.) Each is given a testamentary power of appointment over the corpus. (R. 34-35.) The trustee is authorized to invade the corpus of each estate to the extent of $5,000 a year, should that be necessary for the proper support and maintenance of the beneficiary. (R. 34-35.) Each beneficiary is given the power upon reaching the age of 55 to invade the corpus to the extent of $10,000 per year, this power being cumulative. (R. 34-35.) Grace Collins reached the age of 55 in 1949 (R. 34), and Walter Gibson, Jr., will reach the age of 55 in 1958. (R. 35.) We believe that the mere presence of the testamentary power of appointment is sufficient to show an identity between these two trusts and the beneficiaries. The wide powers of invasion given both to the trustee and the beneficiaries serve only to strengthen this identity. With respect to the one-

eighth of the judgment which would be paid to Walter Gibson, Jr., there is of course no problem since this would be paid outright. (R. 35.)

With respect to the one-fourth which would be paid in trust to Grace Collins, practically the same situation exists as that with respect to the two trusts previously mentioned. While no testamentary power of appointment was given to Grace Collins, the corpus will, if she becomes a widow, be paid over to her free of trust. In addition, she has the power to invade the corpus to the extent of $5,000 per year. There is no age limitation on this power and the power is cumulative. (R. 36.)

We believe that to the extent of seven-eighths of any judgment which would be entered in this case, the residuary legatees of Emily Gibson's estate would benefit directly. The principles enunciated in *Stone v. White,* 301 U.S. 532, rehearing denied, 302 U.S. 639, therefore apply, and the Government's right to seven-eighths of the amount sought is equal or paramount to that of the taxpayer.

We wish to point out that the Government is not here contending that the taxpayer is estopped from bringing this action as it did in *United States v. S. F. Scott & Sons,* 69 F.2d 728 (C.A. 1st), cited by the taxpayer. (Br. 30.) In fact, it concedes that should judgment be entered, the taxpayer's right to one-eighth of the amount is paramount. What it does contend is that upon equitable principles it has a right to recoup the amount that will go to those who should bear the burden of the tax on this very same income.

Stone v. White, supra. We do not read *McEachern v. Rose,* 302 U.S. 56, relied on by taxpayer (Br. 24), as overruling or limiting the principles laid down in *Stone v. White.* In fact, the Court in that case expressly approved its prior statement. In speaking of *Stone v. White,* it said (p. 63):

> Equitable considerations not within the reach of the statutes denied a recovery. It was enough, in the peculiar facts of the case, that the trustees had suffered no burden and that the Government was not unjustly enriched.

We submit that should judgment be entered in favor of the taxpayer, that is exactly the situation that will prevail. If the Government retains seven-eighths of the amount, the taxpayer will have suffered no burden and the Government will not be unjustly enriched. In attempting to escape the effect of the *Stone v. White ruling,* the taxpayer relies heavily on *Benfield v. United States,* 27 F. Supp. 56 (C.Cls.), *McNaghten v. United States,* 17 F. Supp. 509 (C.Cls.), and *Sewell v. United States,* 19 F. Supp. 657 (C.Cls.). (Br. 27-28, 28-29, 32-33, 35.) The *Sewell* case is distinguishable in that there was a complete lack of identity between the beneficiary who should have paid the tax and the remainderman who sought to recover an overpayment. The court also held in the *Benfield* case that there was a lack of substantial identity between the parties seeking to recover and the parties on whom the tax should have fallen. The Court of Claims indicates, however, in both the *McNaghten* and *Benfield* cases that in order to recoup the tax

that should have been paid the Commissioner must have mistakenly relied on some court decision which was later overruled. While this was actually the fact in *Stone v. White, supra,* we do not read the Supreme Court's opinion as being based upon it, but rather as being based upon the equitable considerations present. It is significant that in the *Benfield* case the Court of Claims states that recent cases have placed a limitation upon the rule laid down in *Stone v. White.* In support of this, however, it cites only its own prior decisions in *McNaghten* and *Sewell.*

It is true that should the Court render judgment in favor of the taxpayer in this case, that judgment will operate to lift the bar against assessment of the tax against the estate of Emily Gibson or its transferees in accordance with Sections 1311 through 1315 of the Internal Revenue Code of 1954. (26 U.S.C. 1952 ed., Supp. II, Secs. 1311-1315.) However, a sound, equitable basis exists for recognizing and allowing recoupment to the extent of their interest in any judgment here. The mere fact that another remedy exists is no bar to asserting an equitable remedy in this action. To the extent that recoupment is allowed, it will of course avoid circuity of action.

CONCLUSION.

For the reasons given above, the judgment of the District Court should be affirmed.

Respectfully, submitted,

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July, 1956.

(Appendix Follows.)

Appendix.

Appendix.[6]

EXHIBIT 1.

I, Walter D. K. Gibson, of the City and County of San Francisco, State of California, being of sound and disposing mind and memory, do make, publish and declare this to be my Last Will and Testament, in manner following, that is to say:

First: I hereby revoke all former wills and testamentary dispositions heretofore made by me.

Second: I hereby declare that all my property and estate, of every kind and description and wherever situate, are the community property of myself and my wife, Emily A. Gibson; and that it is my understanding that, under the laws of the State of California, my said wife may elect to take one-half (½) of all my property and estate absolutely as her own, free and clear of the provisions of this my Last Will and Testament; or that, at her election, she may waive such right and elect to accept the provisions of this my Last Will and Testament. The provisions of this my Last Will and Testament are made and are conditioned upon the assumption that my said wife will in fact waive her right to take one-half (½) or any part of my property and estate absolutely as her own, and that she will elect to accept the provisions of this my Last Will and Testament made herein for her benefit.

* * * * * * *

[6]Pertinent portions of Exhibit 1 and Exhibit 2 are printed in accordance with the terms of the "Supplement To Designation of Record For Printing," filed with this Court on or about March 12, 1956.

Fifth: In the event that my said wife shall survive me, all the rest, residue and remainder of my estate I give, devise and bequeath to Wells Fargo Bank & Union Trust Co. (of San Francisco), in trust, nevertheless, to and for the uses and purposes and upon the terms and conditions following:

* * * * * * *

(3) The Trustee shall set aside all the rest of the trust estate * * * which said trust estate shall be known as the Emily A. Gibson Trust Estate. The Trustee shall pay the net income therefrom to my said wife during her lifetime. My said wife shall also be entitled to withdraw such portions of the corpus of said Emily A. Gibson Trust Estate (not exceeding, however, in all one-half (½) of the amount of the corpus thereof) from time to time and for any purpose as she may desire.

* * * * * * *

EXHIBIT 2.

I, Emily A. Gibson, the wife of Walter D. K. Gibson, hereby state that I have read the foregoing Last Will and Testament of my husband dated August 31, 1937, and in consideration of its provisions therein contained for my benefit and for the benefit of others therein mentioned, I agree to accept the terms thereof, and I hereby waive my right to claim one-half (½) or any part of the community property of myself and husband upon his death prior to my decease.

Dated: August 31, 1937.

EMILY A. GIBSON.